Nos. 87-826, 87-1101

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

JEROME F. GOLDBERG and ROBERT MCTIGUE,
Appellants,
v.
ROGER D. SWEET, Director of the Illinois Department of Revenue, *et al.*,
Appellees.

GTE SPRINT COMMUNICATIONS CORPORATION,
Appellant,
v.
ROGER D. SWEET, Director of the Illinois Department of Revenue, *et al.*,
Appellees.

On Appeal from the Supreme Court of Illinois

BRIEF OF THE NATIONAL TAXPAYERS UNION AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

WILLIAM C. LANE *
419 West Broad Street
Falls Church, Virginia 22046
(703) 241-5411

Attorney for Amicus Curiae National Taxpayers Union

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

Nos. 87-826, 87-1101

JEROME F. GOLDBERG and ROBERT MCTIGUE,
Appellants,
v.

ROGER D. SWEET, Director of the Illinois Department of Revenue, *et al.,*
Appellees.

GTE SPRINT COMMUNICATIONS CORPORATION,
Appellant,
v.

ROGER D. SWEET, Director of the Illinois Department of Revenue, *et al.,*
Appellees.

On Appeal from the Supreme Court of Illinois

BRIEF OF THE NATIONAL TAXPAYERS UNION AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

Having obtained the written consent of the parties pursuant to Rule 36.2 of the rules of this Court,[1] the National Taxpayers Union submits this brief as amicus curiae, on behalf of the thousands of individual taxpayers who are its members, and respectfully suggests that this court should reverse the decision below.

[1] Copies of the consent letters have been filed with the Clerk.

INTEREST OF THE NATIONAL TAXPAYERS UNION

The National Taxpayers Union (hereinafter "NTU") is a nonprofit, membership organization devoted to protecting the interests of federal, state and local individual taxpayers through public education, lobbying and litigation on tax and spending issues. NTU's nearly 150,000 members have a direct economic interest in this action. First, as Illinois citizens and taxpayers, many NTU members are directly and adversely affected by the Illinois telephone tax. Second, if this Court upholds the decision of the Supreme Court of Illinois, NTU members throughout the United States may soon be subjected to similar taxes in their own jurisdictions.[2]

STATEMENT OF THE CASE

The Illinois Telecommunications Excise Tax Act, Ill. Rev. Stat. ch. 120, para. 2001-2021, imposes a tax (the "telephone tax") "upon the act or privilege of originating in this State or receiving in this State" interstate and intrastate telecommunications. Secs. 2002-2004. The tax is imposed at the rate of 5% of the "gross charge" for telecommunications purchased at retail in Illinois and billed to an Illinois address. *Id.* "Gross charge" is defined as "the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services . . . provided therewith . . .", excluding, *inter alia*, charges for customer equipment when such charges are "separately identified from other charges." Sec. 2002(a).

The tax reaches both "intrastate" and "interstate" telecommunications. Secs. 2003-2004. The statute defines "interstate telecommunications" as "all telecommunications that either originate or terminate outside this State."

[2] Numerous states, and even municipalities, now tax interstate telecommunications, as noted in the opinion below, and in the Goldberg Jurisdictional Statement (at 25 n.20 & 27 n.24).

Sec. 2002(d). Thus, the Act taxes long distance charges for both domestic and overseas calls. A credit is provided under sec. 2004 of the statute against any tax due from a taxpayer who has paid two or more taxes on the same interstate communication, but the taxpayer must provide specific "proof" of his or her eligibility for the credit, including apparently proof that the tax paid to the other state was "properly due." *Id.*

From the consumer's perspective, the tax is imposed on three items: the basic monthly charge for telephone service; any long distance charges; and any message unit charges incurred for local calls beyond those which are provided as a part of basic service. The economic effect of the tax differs in each case.

The basic service charge is a payment made for the right to access the telephone network. In the telecommunications industry, it is frequently referred to as a charge for "dial tone." In Illinois, as in much of the nation, one can purchase several types of basic service. These range from "unlimited" local service, which includes the right to make an unlimited number of free calls within a local calling area; to various budget plans, under which the consumer is entitled to a fixed number of local calls, with additional calls being subject to a small message unit charge; to "measured zero" service, under which the customer incurs a message unit charge on every local call.[3] Even in places which do not offer unlimited free calling throughout the local calling area, local calls within a fixed geographic radius of the caller's telephone typically carry only one message unit, regardless of duration.[4]

[3] Not all areas have all three types of plan. For example, residential subscribers in Peoria have a choice between "measured zero" and unlimited service within their local calling area.

[4] In the Chicago area, for example, this local radius is about eight miles.

Under any of these plans, the charge for basic telephone service is a fixed monthly charge, and the percentage tax imposed on it has a character of a "lump sum" tax. For example, a consumer with "unlimited" local service may make no local calls in a given month, or a thousand local calls. In either event, he pays the same amount of tax. His tax rate, at the margin, is zero. Thus while the tax may cause some low income consumers to forego telephone service entirely, it will have no effect at all on the local calling patterns of consumers who retain unlimited service. Nor, so long as they remain below their monthly allowance, will it have any effect on the local calling patterns of individuals with "budget" type services.[5]

On the long distance portion of the bill, the consumer is charged for using the long distance network. Charges vary as a function of the number of calls made, the locations called, their duration, and the time of day. Thus, as applied to long distance calls, the telephone tax is a true excise tax, in that it systematically increases the price of the item taxed by a fixed percentage. In so doing, it necessarily reduces consumption of that item—in this case, long distance services.

As applied to message unit charges, the telephone tax shows aspects of both a lump sum and an excise tax. It is a lump sum tax to the extent that it frequently does not vary with the duration of the call, or the location called.[6] It is an excise tax because it does vary with the number of calls made each month by an individual consumer over and above his basic allotment. Moreover, the amount involved per call (five cents per message unit in Chicago for example) is typically very small by comparison with long distance charges for calls of the same duration.

[5] For a more extended discussion of the differences between lump sum taxes and true excise taxes in their effect on consumer behavior, see Koch, *Microeconomic Theory and Application*, 238-239 (Little, Brown & Co. 1976).

[6] This is the case, for example, for calls made in the Chicago area to points within approximately an eight mile radius of the caller's telephone.

Most intrastate telephone calls in Illinois are local, and many, if not most, local phone calls carry either a single message unit or no message unit charge. On the other hand, nearly all interstate calls from and to Illinois are long distance.[7] In these circumstances, a tax imposed as a flat percentage of all local and long distance telephone charges will systematically raise the marginal cost of making interstate telephone calls without having the same impact on most intrastate calls.

SUMMARY OF ARGUMENT

As the Illinois Supreme Court properly found, "[a] person simply cannot make or receive an interstate telecommunication without activating and participating in a complex network of interstate transmissions culminating in interstate communication. We believe that such interstate communication is interstate commerce. The very process of interstate communication is interstate commerce." Jurisdictional Statement, at 9a. Given this cognizance, the Illinois Supreme Court sought to apply the test enunciated by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *reh'g denied*, 430 U.S. 976 (1977), under which a state is required to (1) tax no more than that portion of interstate commerce which is fairly allocable to activities within its borders; (2) not impose taxes that effectively discriminate against interstate commerce, regardless of the facial neutrality of such taxes; and (3) structure the tax so that it bears some reasonable relationship to the value of the services provided by and within the state.[8] But the court erred

[7] A small number of interstate calls, e.g., those from Moline to Davenport, are within a local calling area.

[8] The first prong of the test, that a state must have a sufficient "nexus" with the activity being taxed, is not in dispute here.

in its application of this test by failing to consider the real-world effects of the tax. This brief seeks to demonstrate the manner in which some of those real-world effects result in the tax violating all three of the above-listed elements of the *Complete Auto* test.

ARGUMENT

The failure of the Articles of Confederation was largely attributable to the inability of the government created under it to prevent destructive trade barriers from being erected by the several states. In fact, this weakness of the Confederation gave the main impetus to the Constitutional Convention, and the formulation at that Convention of the Commerce Clause. The principle aim of this Clause was to create among the now "united" States the world's first common market on a continental scale. "The very purpose of the Commerce Clause was to create an area of free trade among the several states." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

Since at least *Gibbons v. Ogden*, 9 Wheat. 1 (1824), and *Brown v. Maryland*, 12 Wheat. 419 (1827), this Court's vigorous enforcement of the Commerce Clause has guaranteed that the United States would remain, economically, one nation. State governments, facing constantly changing technologies and patterns of trade, have repeatedly invented ingenious schemes for taxing commerce with non-residents more heavily than similar commerce involving residents; and this Court has just as repeatedly struck down all such schemes. See, most recently, *American Trucking Associations, Inc. v. Scheiner*, 107 S. Ct. 2829 (1987). Given the absence of substantial Congressional direction in this area, it has been principally this Court's steadfastness on the issue that has maintained the American common market by preventing impermissible barriers to interstate commerce to stand. The benefits to the nation of this long tradition of vigilance have been incalculably great.

This case involves another state scheme aimed at balkanizing the nation's economy—a tax that appears facially neutral, but which upon even a cursory analysis shows itself to be highly discriminatory against interstate commerce. For all commercial activities carried out by telephone, the tax systematically raises the relative cost of interstate as opposed to intrastate transactions, and awards Illinois business an unwarranted advantage in competing for Illinois trade. Ironically, this latest effort is aimed at precisely that sector of the economy which has, and will increasingly become, the irreplaceable electronic link among all Americans—the telecommunications industry.

I. The Telephone Tax is Unapportioned, and This Deficiency Cannot Be Corrected by the Credit Provided for Tax Payments to Other Jurisdictions.

As the Court below acknowledged, the Illinois telephone tax is completely unapportioned. Jurisdictional Statement, at 10a. The Supreme Court of Illinois excused this clear violation of the first *Complete Auto* standard on two grounds. First, on the basis of no record evidence, it concluded that no state other than Illinois could tax a call originating in Illinois and billed to an Illinois address. *Id.* Of course, this is not the case. For example, a state could constitutionally place a flat tax on each *usage* of a telephone instrument within the state, whether for sending or receiving a call. Such a tax would meet all facets of the *Complete Auto* test, and yet would necessarily result in multiple taxation of calls originating and billed in Illinois. Under *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this example alone is sufficient to condemn the challenged law.

But although it neglected the obvious possibility for double taxation of calls originating in Illinois, even the Court below admitted that there was a real "risk of multiple taxation" with respect to that portion of the

telephone tax which applies to calls originating outside Illinois, and billed to an Illinois service address. Indeed, the Court noted that this risk is already a reality when the Illinois tax is considered along with taxes levied by two communities in Colorado. Jurisdictional Statement, at 12a. The lower Court's only answer to this dilemma was its reliance on the credit permitted against the Illinois tax under section 2004. But that reliance is misplaced.

First, while the Illinois telephone tax is collected from taxpayers by a "retailer" doing business in Illinois, it is apparently the taxpayer, and not the retailer, who must provide "proof" that he or she has paid a "tax properly due" to another jurisdiction. Section 2004. Thus it is at least questionable on this record whether a long distance company which transmits a call between Illinois and another jurisdiction has any obligation at all to deduct a tax paid to that other jurisdiction from the tax it collects from the Illinois taxpayer and remits to the state.[9]

But even assuming that such an obligation is imposed on telephone companies operating inside Illinois, it is unlikely that it would or could be uniformly observed by all telephone companies providing service to Illinois consumers. Today, most long distance carriers operate through their own lines across much less than the whole nation, interconnecting into areas they do not serve through some other carrier. Assume that the ABC Company provides long distance services to a Florida resident, and originates a call to Illinois, which is billed to an

[9] If individual taxpayers are required to file monthly or quarterly returns to apply for credit against taxes paid, then, for the average individual taxpayer represented by NTU, the credit provision of the tax becomes absolutely meaningless. The only way in which that provision can have any effect at all is for the credit to be calculated by the various long distance telephone companies when they calculate their customers' monthly bills. But, as shown below, even that prospect may be largely illusory in the circumstances of today's fragmented telephone industry.

Illinois service address. But the ABC Company does not operate in Illinois; to reach Illinois it must interconnect with the XYZ Company. Similarly, the XYZ Company does not operate in Florida. The ABC Company has no knowledge of the Illinois telephone tax, and no legal obligation under Illinois or any other law to calculate credits against that tax; it merely adds a Florida tax to the amount it bills the XYZ Company for the transmission. The XYZ Company has no knowledge of taxes imposed on long distance telephone calls originating in Florida—whether imposed by the State of Florida or by one or more of thousands of Florida municipalities—so it does not claim the credit. And of course, the Illinois taxpayer who receives the call has no knowledge of local Florida tax law, nor should he be expected to have such knowledge. In these not very unlikely circumstances, the credit supposedly allowed under the Illinois tax could not be anything other than hypothetical and illusory.

Electronic telecommunications are the messengers of modern times. If Illinois attempted to tax United Parcel Service on its entire charge for all packages picked up in the state, regardless of where they were to be delivered, that tax would fall before the Commerce Clause. *Japan Line Ltd., supra.* Yet telecommunications companies, whether they are in the telephone, telegraph, or electronic data transmission business, provide a service which for many purposes is functionally identical. Even under the loose standards adopted by the Court below, an unallocated tax on these services is equally invalid.

II. The Telephone Tax Discriminates Against Interstate Commerce.

"No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977). To decide the issue

of discrimination, this Court looks to the practical economic effects of a tax, not to the mere form of words used in the statute. *Complete Auto Transit, Inc. v. Brady, supra.* The validity of a tax will not be saved by showing that it might be constitutional under particular economic, geographic, or political conditions. A tax will be struck down if it is discriminatory, either on its face or as applied, under *any* reasonably conceivable circumstances. *Armco Inc. v. Hardesty,* 467 U.S. 638 (1984).

A concrete example will demonstrate that the telephone tax cannot meet this test. Consider two businesses, one located in Waukegan, Illinois and the other in Gary, Indiana: both businesses send catalogues to consumers in Chicago, and encourage those consumers to call in their orders by telephone. A five minute call to Waukegan (over a distance of about forty miles) costs a Chicago consumer (day rates, station to station) 26 cents, and incurs a telephone tax of 1.3 cents. A call to Gary from the same consumer (over a distance of about twenty miles) incurs a charge of $1.42, and a telephone tax of seven cents. The telephone tax penalizes the Gary catalogue business, and benefits the Waukegan business—precisely the result prohibited by the Commerce Clause. In fact, the tax paid on the call to Gary is more than *five* times as great as the tax on the call to Waukegan.[10] Moreover, the telephone tax does not have a compensating reverse effect when Gary consumers are substituted in this illustration for Chicago consumers. In that reverse case, neither call bears any tax, and the Gary catalogue business is not benefitted by the Illinois telephone tax.

[10] This result is not an accident resulting merely from the choice of cities made in constructing the foregoing example. Because local calling areas typically end at state boundaries (except where a single metropolitan area straddles the border), this result applies to nearly all comparisons of relatively short distance intrastate calls with interstate calls of an equivalent or lesser distance.

In *Westinghouse Electric Corp. v. Tully,* 466 U.S. 388, 395 n.9 (1984), this Court used "[h]ypothetical examples [to] demonstrate that similarly situated corporations . . . would face different tax assessments in New York depending on the location from which [each] shipped its exports." On the basis of such examples, the Court noted that this tax scheme, "not only . . . 'provide[d] a positive incentive for increased business activity in New York State' . . . but also penalize[d] increases in . . . shipping activities in other states." *Id.,* at 395-396. Similarly in this case, the telephone tax penalizes out-of-state businesses which wish to increase their sales or customer relations activities in Illinois by making access to those businesses more costly for Illinois consumers.

The discriminatory effect shown in the foregoing discussion cannot be justified by the fact that the dollar amounts at stake on each individual transaction are small, or by the argument that Illinois consumers would be more likely to interact with Illinois businesses in any event. This Court rejected these precise arguments in *Boston Stock Exchange, supra,* at 334, n.13. "Even if we did not conclude that . . . sellers are likely to rely on economic rather than geographical factors in choosing an exchange, [the challenged tax] would fall before the Commerce Clause. . . . [T]he Clause protects out-of-state businesses from *any* discriminatory burden on their interstate commercial activities." (Emphasis added.)

Beyond examples like the one above, however, the very core of this tax is its frontal assault on the most important instrumentality of interstate commerce. Over a century ago, in *Robbins v. Shelby County Taxing District,* 120 U.S. 489 (1887), this Court found that the imposition of a state "license fee" upon those engaged in the door-to-door selling of items to be delivered at a later time was in violation of the Commerce Clause. While such a tax appeared facially neutral, this Court found that interstate businesses would be more likely to use

this method of sale than local retailers, and therefore determined that the tax impermissibly discriminated against interstate commerce. Taxation of the only activity that would allow interstate businesses to compete was impermissible. "[T]he tax authorized by the State of Tennessee in the present case is discriminative against the merchants and manufacturers of other states. They can only sell their goods in Memphis by the employment of drummers and by means of samples; whilst the merchants and manufacturers of Memphis, having regular licensed houses of business there, have no occasion for such agents. . . ." 120 U.S., at 498.

There is at least an equally discriminatory impact here. Illinois has attempted to tax, without apportionment, the very instrumentality (interstate telecommunications) that is the central nervous system of every interstate business, and to do so by means of a tax which has a different and more burdensome effect on most interstate telecommunications than on most intrastate telecommunications. See, *supra*, at 7, 10. The Illinois telephone tax is essentially a tax on the privilege of communicating with people outside the state of Illinois, structured so as to reduce the demand for such communications, yet having little or no effect on the demand for intrastate communications.[11] It would be hard to conceive of a more effective or efficient deterrent to interstate commerce, or a more powerful incentive for the members of a single state or

[11] Since Illinois is a large state, the tax on a small minority of intrastate calls (for example from Chicago to Cairo) may approximate that on interstate telephone communications over equal or greater distances. But these are the exceptions, not the rule. The vast majority of intrastate calls are local free or message unit calls, or calls like that from Chicago to Waukegan which bear very low charges. Moreover, if the Illinois tax is approved by this Court, identical taxes in other, smaller states will be immune from constitutional challenge. Thus, even states like Rhode Island, where most of the population can make unlimited free calls to nearly the entire state, could adopt with impunity a tax modeled on the Illinois statute.

locality to deal solely with each other. Because the Illinois telephone tax discriminates against interstate commerce, it must be struck down.

III. The Tax Bears No Reasonable Relationship to the Value of Services Provided by the State of Illinois.

The fourth prong of the *Complete Auto* test requires a state tax on interstate activity to be "fairly related to the services provided by the State." 430 U.S., at 279. This test has been explained as requiring "the incidence of the tax as well as its measure [to be] tied to the earnings which the State . . . has made possible. . . ." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981). But the measure of the Illinois tax is in no way tied to the earnings and charges which Illinois has made possible in respect to interstate calling. Instead, calls which make more extensive use of out-of-state equipment are taxed more heavily than those which use more in-state equipment, as may be seen in the following examples:

A half hour call from Chicago to East St. Louis, Illinois originates with an Illinois telephone, is handled by an Illinois local operating company, an Illinois long distance company, and a second Illinois local operating company, and ultimately reaches an Illinois called party. In each of these five stages, this intrastate call involves persons and facilities enjoying the protections and benefits of Illinois law. This call costs $7.64, plus a telephone tax of 38 cents.[12]

A half hour call from Chicago to Honolulu originates with an Illinois telephone, is handled by an Illinois local operating company and long distance company, then is transferred to an out of state long distance company and a Hawaiian local operating company before it finally

[12] All charges in this example are day rate, station to station, AT&T.

reaches a called party in Hawaii. This call uses far *fewer* facilities having contact with Illinois than the call to East St. Louis. Yet this call bears a *higher* telephone tax of 56 cents, on a charge of $11.19.

A half hour call from Chicago to Bangkok, Thailand passes through the same Illinois equipment as the call to Honolulu, and like that call uses fewer in-state facilities than the call to East St. Louis. But the call to Bangkok uses a huge amount of additional telephone equipment located outside both Illinois and the United States. The cost of these extensive international facilities drives the price of such a call up to $35.46, plus a telephone tax of $1.77.

In short, the telephone tax imposes a higher *amount* of tax on activities with *fewer* in-state contacts. The value of services provided within Illinois is substantially less in the case of the calls to Honolulu and Bangkok than in the case of the call to East St. Louis, but the tax imposed is higher.

But even if one assumes (contrary to fact) that the value of the Illinois services involved in each of these calls is *the same*, the tax rate imposed is still higher when the call is made to a place outside Illinois. For example, the tax on the call to East St. Louis constitutes only *5 percent* of the charge attributable to use of the Illinois facilities actually involved in that call; by contrast, the telephone tax on the call to Honolulu constitutes *7.3 percent* of the same $7.64 charge, while the tax imposed on the call to Bangkok constitutes *23 percent* of that same charge. In *Scheiner, supra,* this Court held that, "when the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude . . . that the state is imposing an undue burden on interstate commerce." 107 S. Ct. at 2844. As the foregoing examples show, this is clearly the case with the telephone tax.

CONCLUSION

The *Complete Auto* test is in the conjunctive, and not in the "quasi-disjunctive" that the lower court attempted to apply; a tax must meet each prong of the test to pass constitutional scrutiny. Under these standards, and as applied to the various types of charges described above, the Illinois telephone tax is blatantly unapportioned, discriminatory against interstate communication, and not fairly related to the services provided by the State of Illinois. For these reasons, and for the reasons set forth in the Briefs of Appellants, this Court should reverse the decision below, and find the Illinois telephone tax unconstitutional.

Respectfully submitted,

William C. Lane *
419 West Broad Street
Falls Church, Virginia 22046
(703) 241-5411

Attorney for Amicus Curiae National Taxpayers Union

* Counsel of Record